Accounting Basics, Part 1

It's 10 o'clock, do you know where your money is?

Accrual, Double-Entry Accounting, Debits & Credits, Chart of Accounts, The Journal and, Ledger, etc.

Part 1

What's Here…

- Introduction
- Business Types
- Business Organization
- Professional Advice
- Accounting and Records
- Accrual Accounting
- Basic Bookkeeping
- Chart of Accounts
- Double-Entry Accounting
- Debits & Credits
- The Journal
- The Ledger
- Additional Information
- That's all…

Introduction,
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- Accounting is the bookkeeping methodology involved in creating a financial record of all business transactions and in preparing statements concerning the assets, liabilities and operating results of the business
- Accounting methods and terms have a standardized basis known as:
  - *Generally Accepted Accounting Principles (GAAP)*

Introduction,
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- Causes of recurring business difficulty and failure include:
  - Inadequate planning
  - Lack of business knowledge
  - Lack of capital
  - Poor management, judgment, and decisions
- Successful business managers understand their business information and make comparisons from month-to-month and year-to-year

Introduction,
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- Accounting collects, organizes and presents business information in a timely manner and standardized format
- This series of *training nuggets* outline accounting “basics” with a primary focus on manual, *double entry*, *accrual* accounting processes

Introduction,
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- Additional training products and guides cover:
  - The SAP AIMS accounting system or procedures
  - Budgeting / Forecasting
  - Inventory Management
  - Using financial reports/data
  - Appropriated Fund (APF) accounting and financial processes
- The examples and information in this *training nugget* are based on traditional businesses, not government operations

Introduction,
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- In Part 2, the next *training nugget* in this series, picks up where this one ends. It illustrates and discusses the accounting cycle, adjusting entries, closing entries, trial balance and closing balance.
- In Part 3, also a separate *training nugget*, we illustrate and discuss the Balance Sheet, Income Statement and analyzing these financial reports.

Business Types

- Let’s imagine you are going to open a new business – what will be its purpose?
  - Service
  - Sales
  - Manufacturing

See notes page.

- Why does this matter?
  - This is one important factor in deciding which type accounting systems, processes and methods to use

Business Organization

- How will you structure the business?
  - Sole proprietorship
  - Partnership
  - Corporation
  - Limited Liability Company
- Why does this matter?
  - This decision is another major factor in determining which type accounting systems, processes, and methods you will use

Professional Advice

- Accountants
- Attorneys
- Bankers
- Insurance Agents
- Investment Advisors
- Investors
- Partner/s
- Government agencie
- Vendors / suppliers
- Local business people
- Professional association members

Starting and operating a business *without* professional assistance is ill-advised

Accounting and Records,
Page 1 of 2

- Cash-basis Accounting
- Single-entry record keeping
- Double-entry record keeping
- Accrual-basis Accounting

See Notes Page

These each have merit, purpose, and applicability.

The business type/purpose and size and the ownership structure will determine which accounting method and record keeping system is most appropriate for your business venture.

Accounting and Records,
Page 2 of 2

Typical Business Records:

- General Journal
- General Ledger
- Revenue and Expense Journal
- Petty Cash Record
- Inventory Records
- Fixed Asset Log
- Accounts Receivable
- Accounts Payable
- Independent Contractor Record
- Payroll Records
- Mileage Log
- Travel Record
- Entertainment Record
- Customer Records
- Business Checkbook
- Filing System

Accrual Accounting,

- Businesses can record revenue and expenses in one of two ways – cash-basis or accrual-basis.
- Accrual accounting is used in businesses involved in production, purchase and sale of merchandise. Revenue is a factor.

Accrual Accounting,

- In accrual-basis accounting, revenue is recorded when earned, expenses are recorded when they are incurred whether they are paid or not
- When transactions are posted may have nothing to do with when cash is received or payments are made
- Cash is not necessarily the same as revenue

Basic Bookkeeping,

- Bookkeeping deals with five major accounting categories:
  - Assets
  - Liabilities
  - Net Worth (Equity / Owner's Equity)
  - Revenue
  - Expense
- Accounting is the bookkeeping processes that records financial transactions and creates records and statements concerning the assets, liabilities, and operating results of a business

Basic Bookkeeping,

- Basic bookkeeping process for each business transaction:

  (1) Determine correct account category (assets, liabilities,
  net worth, revenue, or expense)

  (2) Identify correct line item account (e.g., Salaries & Wages;
  Employer Share of FICA; Sick Leave Expense, Annual Leave Expense, etc.)

  (3) Ensure correct amount used when recording (posting) the transaction

  (4) Be consistent and accurate

Basic Bookkeeping,

Page 3 of 3

- Dollar signs are not used in journals or ledgers. They are used in financial reports.
- Commas used to show thousands of dollars are not required in journals or ledgers. They are used in financial reports.
- Decimal points are not required on ruled journals or ledgers. They are used in financial reports.

Chart of Accounts,
Page 1 of 4

- All accounting systems use a Chart of Accounts
  - A listing of accounts in a financial system generally using numeric or alpha-numeric characters to designate the transactions that comprise the Balance Sheet and Income Statement
  - The chart of accounts is used as the basis for preparing financial reports from an accounting system
  - The reports should be designed to capture financial information necessary to make good financial decisions

Chart of Accounts,
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- A Chart of Accounts could include the following account series (groups):
  - 100 - Assets
  - 200 - Liabilities
  - 300 - Net worth
  - 400 - Revenue
  - 500 - Expenses

Chart of Accounts,
Page 3 of 4

Assets	Liabilities	Net Worth	Revenue	Expenses
Cash Accounts receivable Automobile Equipment Building Land Supplies Accumulated depreciation	Accounts payable Note payable Mortgage payable Salaries payable	Capital Withdrawals	Sales Services income Interest earnings	Salaries and wages Utilities Supplies Repairs Rent Office Interest Insurance Advertising Depreciation expense Miscellaneous

Chart of Accounts,
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- Example Chart of Accounts:

100 - Assets
101 - Cash
102 - Accounts receivable
103 - Automobile
104 - Equipment
105 - Building
106 - Land
107 - Supplies
108 - Accumulated Depreciation

200 - Liabilities
201 - Accounts payable
202 - Note payable
203 - Mortgage payable
204 - Salaries payable

300 - Net worth
301 - Capital
302 - Withdrawals

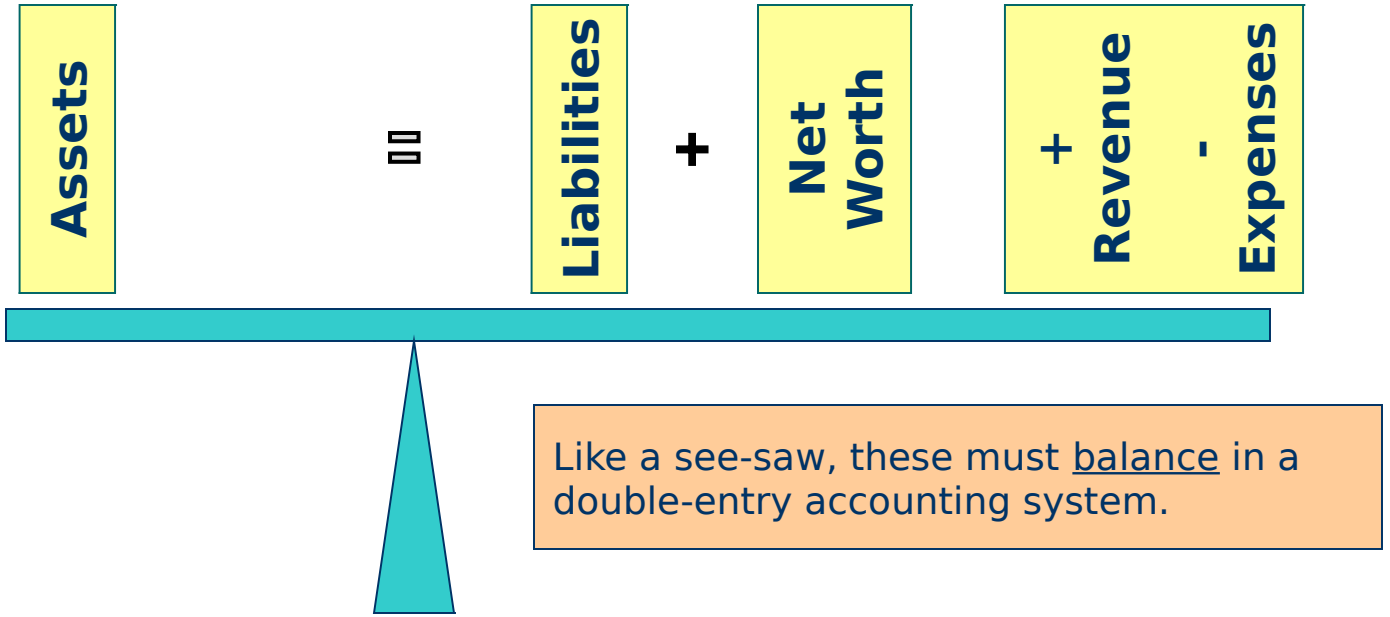
400 - Revenue
401 - Sales
402 - Services Income
403 - Interest Earnings

500 – Expenses
501 - Salaries and Wages
502 - Utilities
503 - Supplies
504 - Repairs
505 - Rent
506 - Office
507 - Interest
508 - Insurance
509 - Advertising
510 - Depreciation Expense
514 - Miscellaneous

The SAP AIMS Chart of Accounts will be introduced in a later *training nugget* in this series.

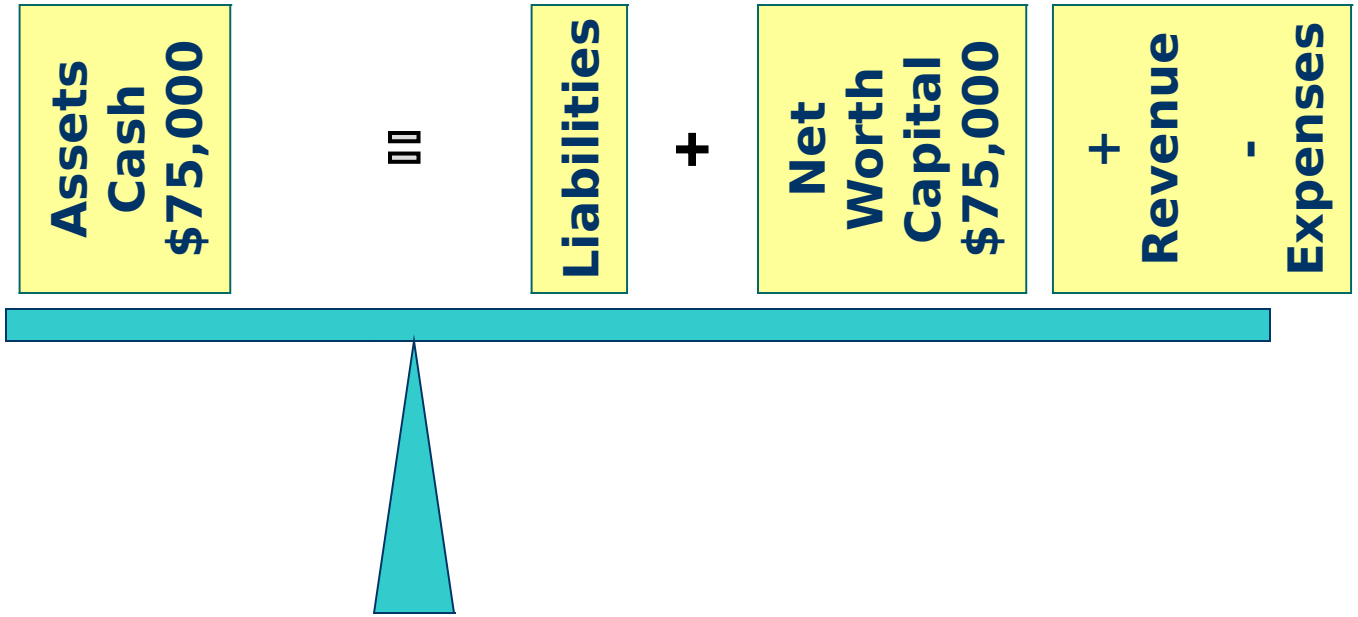
Double-Entry Accounting,

- A double-entry system requires the use of two or more accounts for each transaction



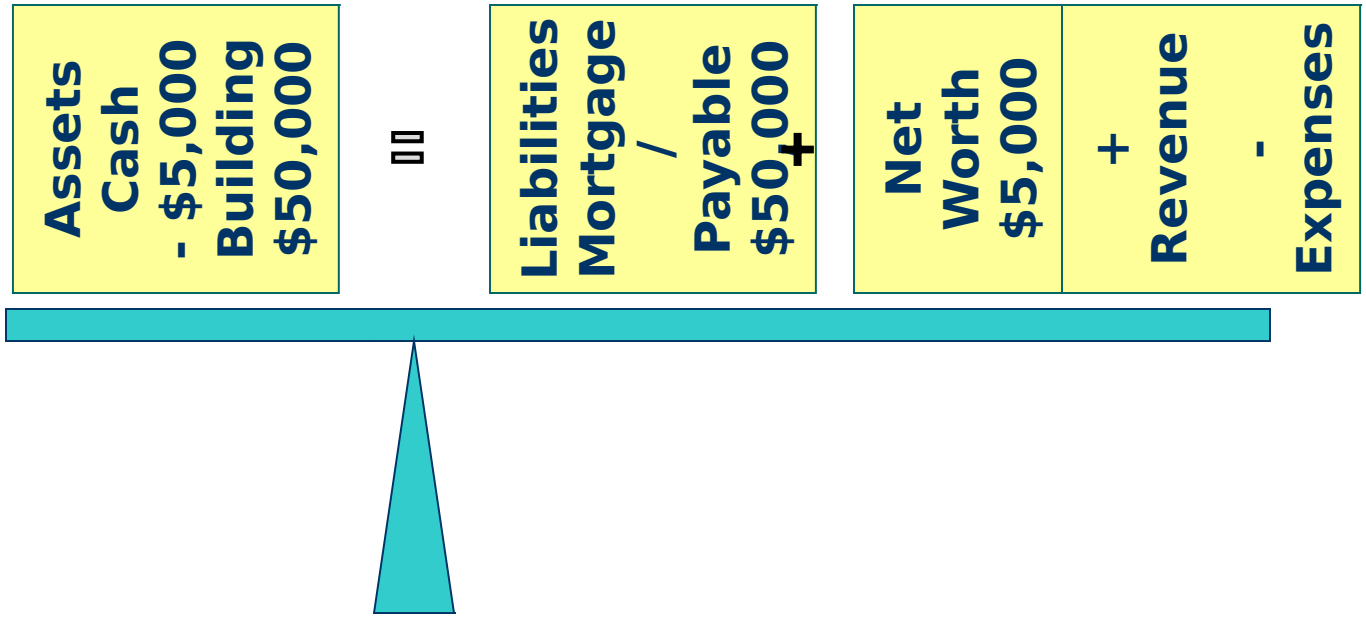
Double-Entry Accounting,

- Example 1 – A business starts with an investment of $75,000 which is recorded (posted) as:



Double-Entry Accounting,

- Example 2 – The business buys a $55,000 building with $5,000 cash and a mortgage which is posted as:



Debits and Credits,
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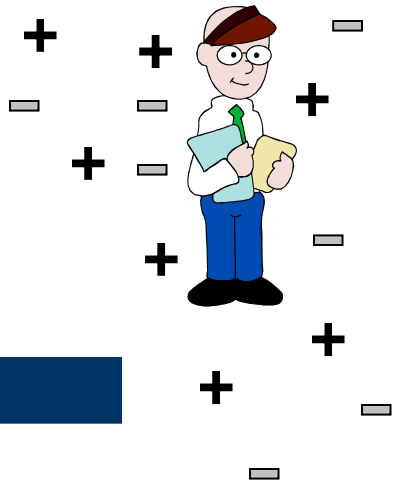
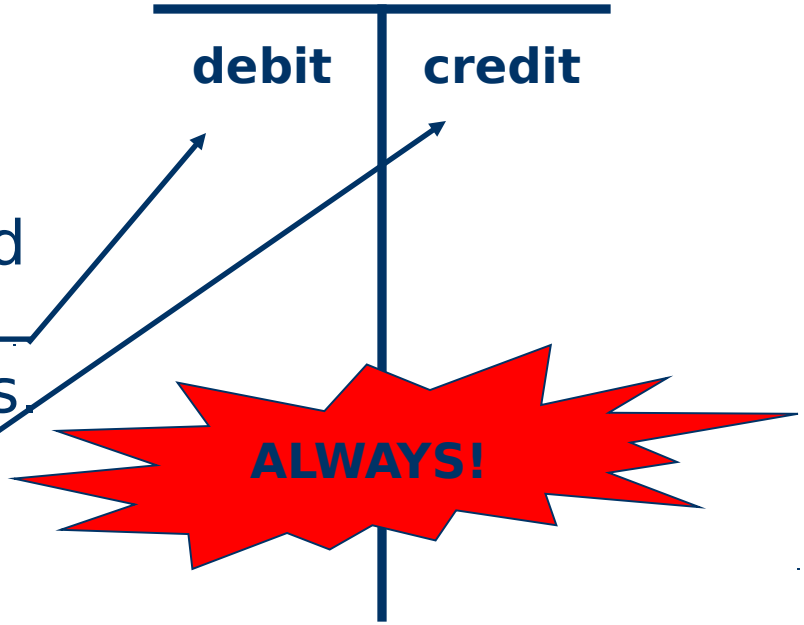


Accountants have used the terms *debit* and *credit* for hundreds of years to describe where numbers are placed in Journals and Ledger Books.

- Debit means left
-

Latin Dr and Cr:
- Dr for Debit
- Cr for Credit



Debits and Credits,
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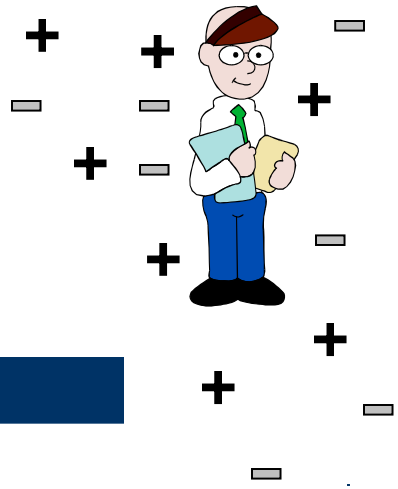

Asset	
Debit +	Credit -

Liabilities	
Debit -	Credit +

Net Worth	
Debit -	Credit +

Revenue	
Debit -	Credit +

Expenses	
Debit +	Credit -

ALWAYS!

When recording transactions in the Journal and Ledgers, the five major account categories are increased or decreased by debits or credits as shown.

The Journal,
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- The Journal or General Journal is used to record all transactions in chronological order
- The Journal is the *book of original entry*
- Entries are made on a daily basis, according to the time and date they occur
- The Journal records debits (left side) and credits (right side) as illustrated on the next slide

The Journal,
Page 2 of 5

Date		Description of Entry	PR	Debit	Credit
20XX					
Mar	1	Cash		40000	
		Capital			40000
		Invested in the business			
	2	Rent		600	
		Cash			600

Indent Credits

Explain transaction

Skip between entries

Record account number **after** amount posted to ledger

The Journal,
Page 3 of 5

Date		Description of Entry	PR	Debit	Credit
20XX					
Apr	1	Truck		28000	
		Cash			10000
		Note payable			18000
		Purchase a new truck			

April 1 – bought new truck. Invested $10,000 cash in truck with remainder on a note payable. The truck cost $28,000.

Truck

28000 Plus (increase)	

Cash

	10000 Minus (decrease)

Note Payable

	18000 Plus (decrease)

The Journal,
Page 4 of 5

Sales Journal

Purchase Journal

Cash Receipts Journal

Cash Disbursement Journal

General Journal

Types of Journals

The Journal,
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Sales Journals	Record only sales on credit
Purchases Journals	Record everything bought on credit
Cash Receipts Journals	Record all incoming cash
Cash Disbursements Journals	Record all outgoing cash
General Journal	Everything not recorded in the other Journals

The Ledger,
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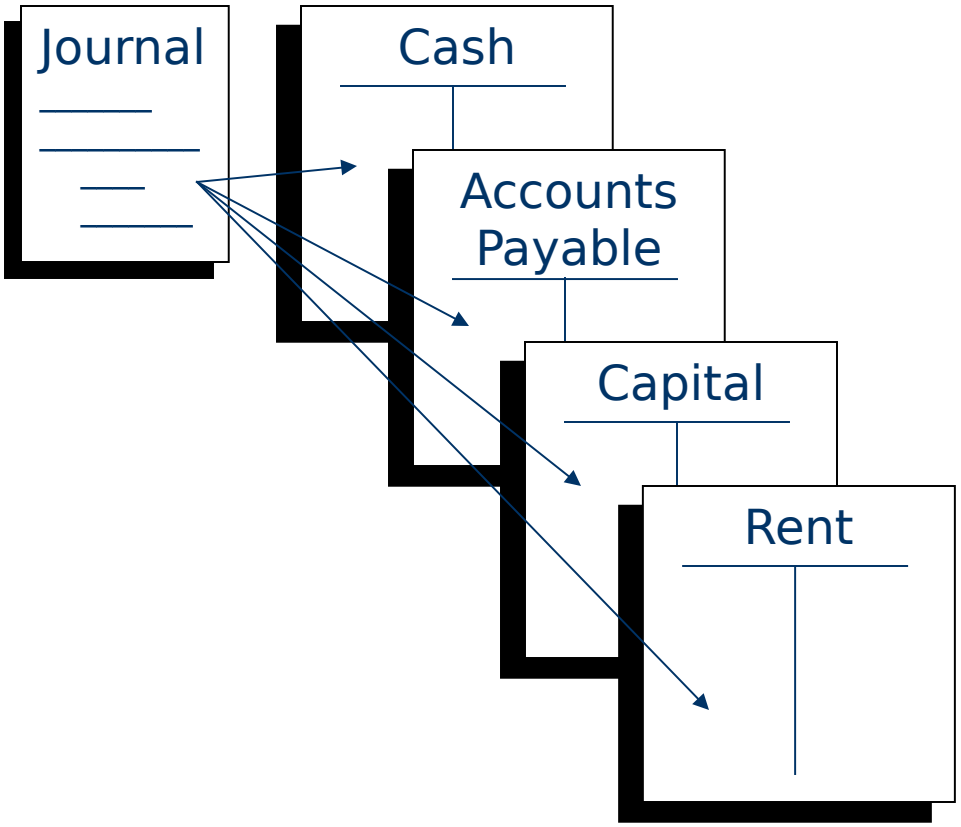

- Each business transaction is recorded in the Journal, then posted (placed) into the applicable Ledger book.
- The Ledger has all the accounts listed in order (assets, liabilities, net worth, revenue, and expenses).

The Ledger,
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Transactions are typically recorded as follows:

- After reviewing details of the transaction, determine the accounts affected
  - Two or more accounts will be affected in a double-entry system
- Decide if the applicable accounts are increased or decreased by the transaction
- Place the correct amount on the proper side of the “T” account to reflect the increase or decrease

Truck	
28000 Plus (increase)	

Cash	
	10000 Minus (decrease)

Note Payable	
	18000 Plus (decrease)

Additional Information, Page 1 of 5

- See the following tasks in the MWR Managers' Desk Reference:
  - 5.1 Prepare NAF Budget Projections
  - 5.2 Prepare APF Budget Input
  - 5.3 Monitor NAF & APF Budget Execution
  - 5.4 Analyze Financial Statements
  - 5.5 Evaluate Current Fees, Prices and Charges
  - 5.6 Control Receipts and Cash
  - 5.7 Manage Petty Cash Fund
  - 5.8 Manage Change Fund
  - 5.9 Close Out Daily Financial Transactions
  - 5.10 Conduct Surprise/Unannounced Cash Count
  - 5.11 Prepare Combined Federal Campaign (CFC) Input
  - 5.12 Determine Break-even Point (BEP)

Additional Information,

- See SAP Training and Documentation at:
  http://mwr.navy.mil/mwrprgms/sap/sap_training_docs_forms.htm
  - User Guides are in the FICO dialogue box
- Check out The Bean Counter website at:
  http://www.dwmbeancounter.com/
- Keeping the Books, Linda Pinson & Jerry Jinnett, 6th Edition, Upstart Publishing, Denver, CO, 2005
- The Accounting Cycle – A Practical Guide To Accounting, Crisp Publications, Inc., Jay Jacquet and William Miller, Menlo Park, CA, 1992

Additional Information,

- Basic Accounting *Training Nugget,* Part 2
  - The Accounting Cycle
  - Adjusting Entries
  - Closing Entries
  - Trial Balance
  - Closing Balance
- Basic Accounting *Training Nugget,* Part 3
  - Balance Sheet
  - Income Statement
  - Analyzing financial reports

Additional Information,

- Small Business Administration (SBA)
  - www.sbaonline.sba.gov/
- Consumer Information Center (CIC)

  PO Box 100
  Pueblo, CO 81002
  www.pueblo.gsa.gov/
- Federal Trade Commission

  6th Street & Pennsylvania Ave NW, Suite 700
  Washington, DC 20580
  www.ftc.gov/

Additional Information,

- U.S. Department of Commerce (DOC)
  Office of Business Liaison

  14th Street and Constitution Ave, NW
  Room 5898C
  Washington, DC 20230
  www.doc.gov/

- U.S. Department of Labor (DOL)

  200 Constitution Ave, NW
  Washington, DC 20210
  www.dol.gov/

That’s all for now…

Do you know where your money is?

Suggestions and requests to:

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